

Auditor IT Experience and Client Benefits

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Research Questions

- ▶ Is audit firm IT experience beneficial to clients?
 - Are auditors with more IT experience able to suggest IT improvements for their clients' internal controls?
 - Does greater IT experience affect other aspects of the audit?

IT Experience

- ▶ We argue that auditors with more IT experience are able to assist their clients in improving internal controls and are better able to comprehend financial reporting systems leading to more effective and efficient audits.

IT Experience Measure

- ▶ Auditors must have more than 60 public clients.
- ▶ Three different measures:
 - Rank of percentage of clients that report IT material weaknesses in 2005.
 - Actual percentage of clients NOT reporting IT material weaknesses in 2005.
 - Rank of percentage of fees from high tech companies.

Background/Motivation

- ▶ The PCAOB's auditing standard number 12 specifically states that auditors “should obtain an understanding of how IT affects the company's flow of transactions” (PCAOB 2010).
- ▶ Additionally, in its quality control standards the PCAOB states that auditors should understand “the manner in which information systems are used to record and maintain financial information” (PCAOB 2000).

Background/Motivation

- ▶ Companies continue to invest in IT for operational performance and financial reporting (Dehning and Richardson 2002; Dehning et al. 2003; Lim et al. 2011).
- ▶ Regulatory and academic literature suggests that IT serves as the foundation of an effective system of internal controls (Hunton et al. 2008; COSO 2009; Masli et al. 2010; Li et al. 2012)
- ▶ Breakdowns of IT controls are detrimental to the company and stakeholders (Klamm and Watson 2009; Haislip et al. 2012).

Background/Motivation

- ▶ Despite these regulatory calls for auditors to gain a better understanding of IT, there is little academic evidence of the effect of auditor IT experience.
- ▶ Practitioners often name IT as an area in which more training and attention is needed (Protiviti 2006; KPMG 2011).
- ▶ Researchers find that auditors are unable to appropriately adjust for IT risks in planning and fail to correctly rely on IT controls (Hunton et al. 2004; Brazel and Agoglia 2007).

Sample Selection

- ▶ Audit Analytics population 2004-2009.
- ▶ 38,443 observations with SOX 404 data.
- ▶ 23,548 company-year observations with all necessary data for 5,505 unique companies.

Research Design

We run logistic and OLS models using the following DVs and Controls when appropriate for the model. Our variables of interest is IT Experience Auditor.

► Dependent Variables

- IT Weakness
- Non-IT Weakness
- Remediate IT
- Remediate
- Audit Delay
- Misstatement
- Discretionary Accruals
(Calculated using the Modified Jones model Dechow et al. 1995)
- LnAudit Fees

► Controls

- LnAssets
- Leverage
- ROA
- Loss
- BTM
- Going Concern
- Inventory
- Receivables
- Segments
- Extraordinary
- Foreign
- Merger
- High Tech
- Big 4
- Specialist
- Restructuring
- Restatement
- Fees Scaled
- Sales Scaled
- Number of Weaknesses
- Weakness
- Audit Delay

Predictions

- ▶ **Prediction 1:** We predict that companies that use auditors with more IT experience are less likely to report IT and non-IT material weaknesses.

Table 4. Likelihood of Reporting Material Weaknesses

	IT Weakness	Non-IT Weakness
Loss	+	+
Extraordinary Items	+	+
Foreign	+	+
Big 4	-	-
Industry Specialist	ns	ns
Auditor IT Experience	-	-

Predictions

- ▶ **Prediction 2:** We predict that companies that change to auditors with more IT experience are more likely to remediate material weaknesses within one year.

Tables 5 & 6. Likelihood of Remediation within One Year

	Remediate IT Weaknesses	Remediate Non-IT Weaknesses
Foreign	-	-
Restatement	-	-
Going Concern	ns	-
Big 4	+	+
Industry Specialist	ns	+
Auditor IT Experience	+	+

Predictions

- ▶ **Prediction 3:** We predict that companies that change to auditors with more IT experience will reduce their audit delays.

Table 7. Audit Delay

	First Year Audit Delay	Change in Audit Delay
Loss	ns	+
Big 4	ns	-
Industry Specialist	ns	ns
Auditor IT Experience	-	-

Predictions

- ▶ **Prediction 4:** We predict that companies are less likely to misstate financial if they use an auditor with more IT experience.
- ▶ **Prediction 5:** We predict that companies will report higher quality earnings (as evidenced by an accruals earnings management measure) if they use an auditor with more IT experience.

Tables 8 and 9. Misstatements and Earnings Management

Misstatement

Earnings Management

Weakness

+

+

Big 4

ns

-

Industry Specialist

ns

ns

Auditor IT Experience

-

-

Table 10. Audit Fees

Misstatement

Earnings Management

Size

+

+

Weakness

+

+

Big 4

+

+

Industry Specialist

-

-

Auditor IT Experience

+

+

Conclusion

- ▶ Our study documents some of the positive outcomes of auditor IT experience.
- ▶ We find that their IT experience allows these auditors to benefit that client by fostering an environment that quickly identifies and remediate material internal control weakness including both IT and non-IT internal controls.
- ▶ The clients of these auditors also face shorter audit delays, are less likely to report misstatements, and report lower levels of earnings management.
- ▶ The evidence suggests that IT auditor experience is an important contributor toward client benefits.